

Revenue Outlook and Forecast

Background

The Revenue Forecasting Committee was established by Executive Order on May 25, 1992, in order to provide the Governor, the Legislature and the State Budget Officer with analyses and recommendations related to the projection of General Fund and Highway Fund revenues. Creation of the committee was in response to the recommendation of Special Commission on Government Restructuring to develop independent and consensus based revenue projections. Public Law 1995, chapter 368 enacted in statute the Revenue Forecasting Committee. This law provided that membership on the committee would include the State Budget Officer, the State Tax Assessor, the State Economist, the Director of the Legislative Office of Fiscal and Program Review and an economist on the faculty of the University of Maine System selected by the Chancellor.

Public Law 1997, chapter 655 expanded membership on the committee to include an analyst from the Legislative Office of Fiscal and Program Review designated by the Director of that office. The revenue projections of the committee also would no longer be advisory but would become the actual revenue projections used by the Executive Branch in setting budget estimates and recommendations and out-biennium budget

forecasts for both the General Fund and the Highway Fund. The State Budget Officer also was empowered to convene a meeting of the committee to review any new data that might become available, affecting the revenue projections for the General Fund and the Highway Fund.

The committee is required to meet at least four times a year or when called by a majority vote of the committee members, or at the request of the State Budget Officer. The committee is required to develop four year revenue forecasts for the General Fund and the Highway Fund, or other funds of the state. No later than December 1st and March 1st annually the committee must submit to the Governor, the Legislative Council, the joint standing committee of the Legislature having jurisdiction over appropriations and financial affairs and the State Budget Officer its findings, analyses and recommendations for General Fund and Highway Fund revenues. The revenue forecasts are developed using econometric models for Sales and Use Tax, Individual Income Tax, Corporate Income Tax, Fuel Tax and Cigarette Tax. Forecasts for the remaining revenue lines are developed using trend data, national economic assumptions, department subject matter experts and operational analysis (e.g., net profit from liquor sales).

Findings (Major Revenue Sources)

Overview – The change in the General Fund forecast is driven primarily by the updated economic forecast of the Consensus Economic Forecasting Commission. The modest growth in the General Fund revenue pattern between FY04 and FY05 and the negative growth between FY05 and FY06 reflect the impact of changes to the revenue pattern through the end of the Second Special Session of the 121st Legislature, which included a number of substantial “one-time” revenue increases. These include the upfront payment for the lease of the wholesale liquor operation, some delays in tax

changes to conform to federal tax changes, Highway Fund contributions to revenue sharing, increases in the General Fund share of the Real Estate Transfer Tax and the Tax Amnesty program.

Sales and Use Tax – Legislative changes during the 121st Legislature (2003 and 2004) increased revenue in this line by approximately \$7.1 million in FY05 and slightly above \$7.5 annually during the 2006-2007 biennium. One component of that legislative package was reversed in this forecast reducing the estimated impact of the legislative changes by approximately \$1.5 million annually. Unlike other revenue lines, the legislative changes did not affect the flow of revenue with one-time or unusual revenue patterns.

Individual Income Tax – The forecast for the Individual Income Tax is consistent with the changes in the economic forecast. The Individual Income Tax is forecast with the input of several economic variables: the components of Personal Income, inflation, total employment growth, the unemployment rate, and the 3-month treasury bill and 10-year treasury note rates. In addition to these economic variables, Maine Revenue Services must also input assumptions about net capital gains (see discussion of Capital Gains Forecast above). For the most part the relationship and the effect of these variables on the individual income tax is obvious. Personal Income and the distribution of that variable into its components (salaries and wages; dividends, interest and rent; proprietor's income; and transfer payments) affect the accuracy of the Individual Income Tax forecast. Part of the problem that resulted in the unpleasant "April Surprise" of 2002 was capital gains, but another third was a problem with the distribution of the components of Personal Income. Since that time, the Consensus Economic Forecasting Commission has spent much more time in evaluating the distribution of Personal Income. The forecast of inflation has some offsetting influences on the forecast. On one hand, a higher rate of inflation will result in a higher forecast of nominal salaries and wages and proprietors' income. On the other hand, the tax brackets are indexed for inflation and a higher rate of inflation will increase the brackets and reduce the rates applied to certain income below the highest bracket.

Corporate Income Tax – The Corporate Income Tax model is driven by employment growth and the CPI forecast. The employment growth assumption increases in each year of the forecast and a higher

estimate of inflation in 2004 results in a net increase in the projections for this tax. The increases in the short-term and the negative growth after FY05 are attributable to recent adjustments to the conformity of state tax law with federal tax laws. Revenue estimates were driven upward for FY04 and FY05, in part, due to the improved underlying economic conditions and to the delayed conformity to the Federal code with respect to bonus depreciation. The delay in conformity causes State tax collections to be higher in FY04 and FY05 and to be lower in the years after that.

Cigarette and Tobacco Tax – This revenue source has been declining on a more accelerated basis. The Revenue Forecasting Committee had forecast significant drops in the sale of cigarette stamps due to effective anti-smoking campaigns, increased rolling of cigarettes, and the loss of sales to out-of-state and internet purchases. The forecast is reduced by an additional \$900,000 annually in this forecast as a result of targeting the model to a reduced base, FY04 revenue from this source was approximately \$1.0 million under budget.

Insurance Company Tax – The forecast for Insurance Company Tax for fiscal years 2003-04 and 2004-05 reflects rising insurance premiums following the terrorist attacks and the stock market correction.

Municipal Revenue Sharing – Sales and Use Tax, Individual Income Tax and Corporate Income Tax are subject to Municipal Revenue Sharing in accordance with Title 30-A, section 5681 of the Maine Revised Statutes. That section of statute requires that an amount equal to 5.1% (5.2% starting with fiscal year 2003-04) of the sales and income tax lines be transferred to the Local Government Fund (Municipal Revenue Sharing). Municipal Revenue Sharing is a calculation based on the forecasts of the sales and income tax lines.

Estate Tax – Estate tax estimates are forecast by Maine Revenue Services using a model based on aggregate Personal Income growth. Looking at aggregated data of actual tax returns using a data warehouse enhances the data and the model. Tax year 2003 returns are the most recent available and is the adjusted base year upon which this forecast

derives. An adjustment is also made to account for additional estate tax planning, which is occurring in reaction to Maine's recent decision to not conform with federal tax law. The unusual 7.2% growth in FY08 is related to federal law changes for the estate exemption amount, which is fully phased-in at \$1 million for deaths occurring in 2006. Previous year growth rates were suppressed by the effect of the phase-in of the exemption.

Transfers to Municipal Revenue Sharing - The amounts transferred for municipal revenue sharing are based on a percentage of the Individual Income Tax, Corporate Income Tax, Sales and Use Tax and the General Fund portion of the Service Provider Tax. Consequently, the estimate of these amounts is a simple calculation based on the forecast for those taxes.

The Revenue Forecasting Committee forecast for General Fund revenues is shown in **Table C - 1**. **Table C - 2** shows the committee's revenue forecast

for the Highway Fund. **Table C - 3** shows the adopted revenue forecast of the committee for Tobacco Settlement Funds.

TABLE C - 1

GENERAL FUND REVENUE FORECAST									
SOURCE	FY 04 ACTUAL	FY 05	% CHANGE	BIENNIUM	FY 06	% CHANGE	FY 07	% CHANGE	BIENNIUM
Sales and Use Tax	917,243,245	914,710,000	-0.28%	1,831,953,245	954,918,500	4.40%	994,344,829	4.13%	1,949,263,329
Service Provider Tax		46,700,000		46,700,000	48,801,500	4.50%	51,095,171	4.70%	99,896,671
Individual Income Tax	1,156,715,909	1,220,849,053	5.54%	2,377,564,962	1,275,740,000	4.50%	1,334,790,000	4.63%	2,610,530,000
Corporate Income Tax	111,616,051	123,351,604	10.51%	234,967,655	113,105,057	-8.31%	106,783,219	-5.59%	219,888,276
Cigarette & Tobacco Tax	96,604,646	96,019,864	-0.61%	192,624,510	95,225,360	-0.83%	94,533,494	-0.73%	189,758,854
Public Utilities Tax	27,991,188	26,675,000	-4.70%	54,666,188	25,440,000	-4.63%	24,495,000	-3.71%	49,935,000
Insurance Company Tax	72,205,855	78,615,872	8.88%	150,821,727	77,141,931	-1.87%	79,644,425	3.24%	156,786,356
Inheritance & Estate Tax	32,070,750	29,042,767	-9.44%	61,113,517	30,100,403	3.64%	31,620,061	5.05%	61,720,464
Property Tax - Unorganized Terr.	10,709,308	10,580,086	-1.21%	21,289,394	10,690,713	1.05%	10,982,067	2.73%	21,672,780
Income from Investments	2,303,652	4,084,735	77.32%	6,388,387	6,046,546	48.03%	6,046,546		12,093,092
Municipal Revenue Sharing	(111,464,335)	(116,324,258)	4.36%	(227,788,593)	(122,892,334)	5.65%	(127,832,161)	4.02%	(250,724,495)
Transfer from Liquor	27,182,743		-100.00%	27,182,743					
Transfer from Lottery	41,272,645	52,292,750	26.70%	93,565,395	52,834,250	1.04%	52,834,250		105,668,500
All Other	299,087,900	236,959,334	-20.77%	536,047,234	151,975,252	-35.86%	169,293,021	11.40%	321,268,273
TOTAL REVENUE	2,683,539,557	2,723,556,807	1.49%	5,407,096,364	2,719,127,178	-0.16%	2,828,629,922	4.03%	5,547,757,100

TABLE C - 2

HIGHWAY FUND REVENUE FORECAST									
SOURCE	FY 04 ACTUAL	FY 05	% CHANGE	BIENNIUM	FY 06	% CHANGE	FY 07	% CHANGE	BIENNIUM
Fuel Taxes	212,600,961	220,838,729	3.87%	433,439,690	229,661,313	4.00%	237,895,577	3.59%	467,556,890
Motor Vehicle Registration & Fees	82,578,703	78,853,234	-4.51%	161,431,937	83,089,158	5.37%	84,291,317	1.45%	167,380,475
Inspection Fees	4,707,716	4,381,459	-6.93%	9,089,175	4,397,970	0.38%	4,414,756	0.38%	8,812,726
Fines, Forfeits and Penalties	1,917,903	946,385	-50.66%	2,864,288	1,556,478	64.47%	1,556,478		3,112,956
Income from Investments	720,046	2,165,359	200.73%	2,885,405	2,248,666	3.85%	2,293,239	1.98%	4,541,905
Other Revenues	9,502,657	14,200,077	49.43%	23,702,734	9,473,596	-33.28%	9,758,864	3.01%	19,232,460
TOTAL REVENUE	312,027,986	321,385,243	3.00%	633,413,229	330,427,181	2.81%	340,210,231	2.96%	670,637,412

TABLE C - 3

TOBACCO SETTLEMENT REVENUE ESTIMATES									
SOURCE	FY 04 ACTUAL	FY 05	% CHANGE	BIENNIUM	FY 06	% CHANGE	FY 07	% CHANGE	BIENNIUM
Initial Payments									
Base Payments	48,952,964	48,491,906	-0.94%	97,444,870	48,739,525	0.51%	49,485,635	1.53%	98,225,160
Attorney General Reimbursements									
Income from Investments	54,830	45,000	-17.93%	99,830	45,000		45,000		90,000
Total - Tobacco Settlement Revenue	49,007,794	48,536,906	-0.96%	97,544,700	48,784,525	0.51%	49,530,635	1.53%	98,315,160

